

QUALIFIED EMPLOYEE STOCK OPTION SCHEME

INTRODUCTION

- 1 Currently, gains from employee stock options (ESOP) are brought to tax as income of the year in which the options are exercised. Unless the employee has arranged to pay his tax by installments, the tax, including the tax on stock option gains, becomes due within one month after it is assessed. To help alleviate the cashflow problems faced by some employees who do not sell their shares after exercising the option and to facilitate the use of stock options as remuneration tool, MOF has decided to introduce the Qualified Employee Stock Option (ESOP) Scheme. Under the scheme, the payment of tax on gains arising from stock options can be deferred for up to five years, subject to an interest charge.
- 2 Following MOF's announcement, IRAS issued a Press Release on 25 October 1999 that broadly sets out the qualifying conditions of the scheme. This practice note seeks to provide further details on the qualifying criteria of the scheme, the terms and conditions for allowing the deferment and the application procedures.

ADMINISTRATIVE PRACTICE

QUALIFYING CRITERIA

Effective Date

- 3 The scheme is available to all shares options granted under a qualified ESOP Plan which are exercised on or after 1 Jan 1999 by a qualifying employee.

Qualified Employee Stock Option (ESOP) Plan

- 4 A qualified ESOP plan is one which satisfies the vesting period requirement currently imposed by the Singapore Exchange (SGX) on companies listed on the SGX. The vesting period requirement is as follows:
 - a. where the exercise price of the share is equivalent to its market value on the date of the grant of option, the option given on the share may not be exercised within 1 year from the grant of the option;
 - b. where the exercise price is at a discount to the market value on the date of the grant of option, the option may not be exercised within 2 years from the grant of the option.
- 5 The market value mentioned in paragraph 4 refers to the market value of the shares at the time the option is granted. Under SGX rules on ESOP Plans of companies listed on the SGX, the market value is the average market price

prevailing during the price fixing period immediately before the options are granted. The price fixing period is explicitly defined for each share option scheme in the company circulars to shareholders which informs them of the proposed motion to approve the share option scheme. The computation of the average market price is decided by the company and is also stated in the same circular. Consequently, for the purposes of the qualified ESOP scheme, if the exercise price were fixed at the average market price prevailing during the price fixing period, a one-year vesting period would apply. If, however, it were fixed at a discount to the average market price, the vesting period would be two years.

6. ESOP Plans in respect of shares of companies listed elsewhere or unlisted companies would have to also satisfy the above vesting period requirement in order to be considered as qualified ESOP Plans. For unlisted companies where the market value of their shares is not readily available, the net asset value of the shares would be used instead.
7. Some companies may have ESOP Plans with staggered vesting period, for example, options in respect of a certain number of shares may be exercised within 2 years while another portion may be exercised after 2 years, etc. In such a situation, options which satisfy the vesting period requirement will be allowed to qualify for the scheme. This is illustrated in the following example:

Example

Year	Percentage of Option Exercisable					Total
	1	2	3	4	5	
	20%	20%	20%	20%	20%	100%

Assume in this case that the vesting period of 2 years under the deferred payment scheme applies. Since part of the options satisfies the vesting period requirement of at least 2 years, that portion would be eligible for the deferred payment scheme, i.e. 60% of the options granted would qualify for the tax deferral scheme.

8. Companies do not have to apply for approval to have an ESOP Plan considered as a qualified ESOP. Companies need only keep sufficient documentation to show, when required by the Comptroller, that the ESOP Plan satisfies the required vesting period.

Qualifying Employee

9. An employee can apply to IRAS for the tax on gains from a qualified ESOP to be deferred at the time of filing his income tax return for the year of assessment in

which the gains are taxable. IRAS will consider the application only if the following conditions in respect of the employee are satisfied:

- a. the employee is exercising an employment in Singapore at the time of exercise of the stock option;
 - b. the stock option was granted to him by –
 - (i) the company for whom he was working at the time of exercise; or
 - (ii) an associated company of the company for whom he was working at the time of exercise; and
 - c. the tax on the ESOP gains is not borne by any employer.
- 10 For this purpose, a company is considered to be an associated company of another company if both companies belong to the same corporate group of companies (e.g. parent and its subsidiaries).
- 11 Generally, IRAS will approve any application made by a qualifying employee for deferral of tax on gains on stock option under a qualified ESOP Plan. However, approval will not be given if:
- a. he is an undischarged bankrupt;
 - b. he is ascertained by IRAS, based on his records, to be a delinquent taxpayer;
 - c. the tax on the ESOP gains is less than \$200; or
 - d. he is granted area representative status or is generally not allowed under existing guidelines to settle his tax by installments.

TERMS AND CONDITIONS FOR DEFERMENT

Computation of tax on ESOP gains

- 12 There will not be any change in the basis of determining when ESOP gains accrue to an employee. The amount of tax to be deferred will be calculated using the employee's marginal tax rate at the time of assessment of the ESOP gains. The tax liability of an employee arising from his income, including the ESOP gains, will be computed in the usual manner to arrive at the final tax payable. The marginal tax rate(s) will then be applied on the ESOP gains to arrive at the amount of tax on ESOP gains.
- 13 If an income tax rebate (e.g. the 10% tax rebate for Y/A 1999) were given, the tax on ESOP gains would be the amount after deducting the corresponding amount of tax rebate. The amount of tax to be deferred would, however, be limited to the actual tax payable arising from the assessment. Annex 1 shows an example of

how the amount of tax to be deferred would be computed. Deferral of part of the tax on ESOP gains is permitted.

- 14 The amount of tax to be deferred as determined under para 10 will be adjusted if there is a change to the chargeable income due to subsequent revisions to the assessment. Annex 2 contains some examples illustrating the adjustments to be made to the tax deferred and the computation of the appropriate amount of interest charge as a result of subsequent assessments.

Period of deferment

- 15 The maximum deferral period of 5 years will commence from the first day of the Year of Assessment for which the ESOP gains are assessed. For example, if the gains were assessable for the Year of Assessment 2000, the 5-year period would be up to 31st December 2004 (i.e. from 1st January 2000 to 31st December 2004). Subject to a maximum of 5 years, an employee can choose to defer the payment of the tax on ESOP gains for any period of time (e.g. 2 years or 3 years, or part thereof).
- 16 The same period of deferral should apply to all gains derived from qualified ESOPs which are assessable to tax in the same year of assessment.

Interest charge

- 17 The interest rate chargeable for the deferral of tax will be pegged to the average prime rate offered by the Big Four banks on 15 April each year. The interest will be computed annually based on the average prime rate as at 15 April. The simple interest method will be used to compute the interest charge. The interest charge will only start to accrue after the expiry of the 1-month period allowed for payment of tax assessed.

Payments of tax deferred and interest charge

- 18 The amount of tax deferred for collection and the appropriate amount of interest charge would become due on the expiry of the deferral period.
- 19 However, a taxpayer may, prior to the expiry of the deferral period, make an early settlement, either partially or in one lump sum. In such instances, the amount of interest charge will be computed taking into account the early settlement. Where a taxpayer makes a partial settlement, this amount will be treated as a payment towards the principal amount of the deferred tax. The appropriate amount of interest charge will be computed when the principal amount of the deferred tax has been fully paid. Annex 3 shows some examples of how interest charge would be computed in cases of partial repayment.

- 20 Deferral of tax payment will cease and payment of the tax plus the appropriate amount of interest charge will generally become due immediately upon the occurrence of any of the following events:
- a. in the case of a foreign employee (including a Singapore PR), when the employee:
 - (i) terminates his employment in Singapore and leaves Singapore; or
 - (ii) is posted overseas; or
 - (iii) leaves Singapore for any period exceeding 3 months.
 - b. when the employee becomes bankrupt; and
 - c. when the employee passes away (the deferred tax and the appropriate interest charge would be recovered from the estate of the deceased).
- 21 In the case of a foreign employee or a Singapore PR who leaves Singapore for any period exceeding 3 months, IRAS will continue to allow the tax deferral if the employee/PR provides proof that he is not leaving Singapore permanently.
- 22 Once deferral of tax on ESOP gains is approved, the deferral will not be terminated merely due to the occurrence of the following events:
- a. the employee sells the shares in respect of which tax deferral on the gains from the exercise of the stock option has been granted;
 - b. in the case of a Singaporean, he ceases employment with the employer for whom he was working at the time of exercise of the stock option in respect of which tax deferral has been granted

Application Procedures

- 23 Any qualifying employee who wishes to avail of the Qualified ESOP scheme would have to:
- a. complete the relevant Part(s) of the Application Form for Deferment of Tax on Gains from Qualified ESOP;
 - b. obtain the employer's certification on the Application Form that the ESOP under which the stock option was granted is a qualified ESOP;
 - c. submit the duly completed and certified Application Form to the Comptroller of Income Tax together with his tax return not later than 15th April (in the case of an employee who e-files his tax return, the Application Form would have to be submitted separately by 15th April).

- 24 Where the stock option was granted under a Group ESOP Plan, the certification on the Application Form may be done by the parent company or the company in the corporate Group for whom the employee is working.
- 25 Employee who has applied for the tax deferral will be notified in writing of the outcome of his application.
- 26 The Application Form can be downloaded from IRAS' website at <http://www.iras.gov.sg> or obtained from IRAS' Fax Express Service by calling 1800-356 8677 (Code No. 114).

Annex 1
Example 1

Tax computation for the year of assessment 2000

<u>Income</u>	\$	\$
Salaries		100,000
ESOP gains		100,000
Singapore dividends		<u>10,000</u>
Total income		210,000
Less: Personal reliefs		<u>22,900</u>
Chargeable income		<u>187,100</u>
Tax payable on first \$150,000	23,775.00	
Tax payable on balance \$37,100 @ 23%	<u>8,533.00</u>	32,308.00
Less: GST rebate*		<u>500.00</u>
		31,808.00
Less: Tax deducted at source		<u>2,600.00</u>
		29,208.00
Less: Special tax rebate (for second child)		<u>10,000.00</u>
Tax payable		<u>19,208.00</u>

* assuming that GST rebate of \$500 is available for YA 2000

Computation of tax on ESOP gains

Amount of ESOP gains		<u>\$100,000</u>
Tax on ESOP gains applying the marginal tax rates:		
Tax payable on \$37,100 @ 23%		8,533.00
\$50,000 @ 22%		11,000.00
<u>\$12,900 @ 20%</u>		<u>2,580.00</u>
Tax payable on <u>\$100,000</u>		<u>22,113.00</u>

The amount of tax on ESOP gains deferred would be limited to \$19,208.00.

Annex 2

Example 2

Computation of the amount of tax on ESOP gains and interest charge

Original Assessment for the year of assessment 2000

<u>Income</u>	\$	\$
Salaries		100,000
ESOP gains		100,000
Singapore dividends		<u>10,000</u>
Total income		210,000
Less: Personal reliefs		<u>22,900</u>
Chargeable income		<u>187,100</u>
Tax payable on first \$150,000	23,775.00	
Tax payable on balance \$37,100 @ 23%	<u>8,533.00</u>	32,308.00
Less: GST rebate*		<u>500.00</u>
		31,808.00
Less: Tax deducted at source		<u>2,600.00</u>
Tax payable		<u>29,208.00</u>

* assuming that GST rebate of \$500 is available for YA 2000

Computation of tax on ESOP gains to be deferred (assuming that taxpayer elects for the tax on the full amount of ESOP gains to be deferred)

Amount of ESOP gains		<u>\$100,000</u>
Tax on ESOP gains applying the marginal tax rates:		
Tax payable on \$37,100 @ 23%		8,533.00
\$50,000 @ 22%		11,000.00
<u>\$12,900 @ 20%</u>		<u>2,580.00</u>
Tax payable on <u>\$100,000</u>		<u>\$22,113.00</u>
Tax on ESOP gains to be deferred		<u>\$22,113.00</u>

Computation of interest charge

Date of original assessment	1 July 2000 (payment due on 31 July 2000)
Deferral period	Up to 31 December 2004
Average prime rate:	
15 April 2000	5%
15 April 2001	5.5%

15 April 2002	5%
15 April 2003	6%
15 April 2004	5%

Interest charge would be computed as follows:

1 Aug 2000* – 14 Apr 2001	$\$22,113 \times 5\% \times 257/365$	778.50
15 Apr 2001 – 14 Apr 2002	$\$22,113 \times 5.5\%$	1,216.22
15 Apr 2002 – 14 Apr 2003	$\$22,113 \times 5\%$	1,105.65
15 Apr 2003 – 14 Apr 2004	$\$22,113 \times 6\%$	1,326.78
15 Apr 2004 – 31 Dec 2004	$\$22,113 \times 5\% \times 261/365$	<u>790.62</u>
Total interest charge (payable on 31 Dec 2004)		<u>5,217.77</u>

* *interest charge starts to accrue after expiry of the 1-.....payment of tax*

Example 3

Computation of revised amount of tax on ESOP gains and interest charge arising from the making of an additional assessment subsequent to the original assessment in Example 2

Additional Assessment for the year of assessment 2000

<u>Income</u>	\$	\$
Salaries		100,000
ESOP gains		100,000
Singapore dividends		10,000
Interest		<u>10,000</u>
Total income		220,000
Less: Personal reliefs		<u>22,900</u>
Chargeable income		<u>197,100</u>
Tax payable on first \$150,000	23,775.00	
Tax payable on balance \$47,100 @ 23%	<u>10,833.00</u>	34,608.00
Less: GST rebate*		<u>500.00</u>
		34,108.00
Less: Tax deducted at source		<u>2,600.00</u>
Tax payable		31,508.00
Less: Tax previously assessed		<u>29,208.00</u>
Additional tax payable		2,300.00
Less: Additional amount of tax on ESOP gains deferred (see next page for computation)		<u>300.00</u>
Additional tax payable under normal arrangement		<u>2,000.00</u>

* assuming that GST rebate of \$500 is available for YA 2000

Revised computation of tax on ESOP gains to be deferred

Amount of ESOP gains		<u>\$100,000</u>
Tax on ESOP gains applying the revised marginal tax rates:		
Tax payable on \$47,100 @ 23%		10,833.00
\$50,000 @ 22%		11,000.00
\$ 2,900 @ 20%		<u>580.00</u>
Tax payable on <u>\$100,000</u>		\$22,413.00
Less: tax on ESOP gains originally deferred		<u>\$22,113.00</u>
Additional tax on ESOP gains to be deferred		<u>\$ 300.00</u>

Computation of interest charge

Date of original assessment	1 July 2000 (payment due on 31 July 2000)
Date of additional assessment	1 Oct 2000 (payment due on 31 Oct 2000)
Deferral period	Up to 31 December 2004
Average prime rate:	
15 April 2000	5%
15 April 2001	5.5%
15 April 2002	5%
15 April 2003	6%
15 April 2004	5%

Interest charge would be computed as follows:

1 Aug 2000 – 31 Oct 2000	$\$22,113 \times 5\% \times 92/365$	278.68
1 Nov 2000* – 14 Apr 2001	$\\$22,413 \times 5\% \times 165/365$	506.60
15 Apr 2001 – 14 Apr 2002	$\$22,413 \times 5.5\%$	1,232.72
15 Apr 2002 – 14 Apr 2003	$\$22,413 \times 5\%$	1,120.65
15 Apr 2003 – 14 Apr 2004	$\$22,413 \times 6\%$	1,344.78
15 Apr 2004 – 31 Dec 2004	$\$22,413 \times 5\% \times 261/365$	<u>801.34</u>
Total interest charge (payable on 31 Dec 2004)		<u>5,284.77</u>

* *interest charge for additional amount of tax deferred will start to accrue after expiry of the 1-month period allowed for payment of the additional tax*

Example 4

Computation of revised amount of tax on ESOP gains and interest charge arising from the making of an amended assessment subsequent to the original assessment in Example 2

Amended Assessment for the year of assessment 2000

<u>Income</u>	\$	\$
Salaries		60,000
ESOP gains		100,000
Singapore dividends		<u>10,000</u>
Total income		170,000
Less: Personal reliefs		<u>22,900</u>
Chargeable income		<u>147,100</u>
Tax payable on first \$100,000	12,775.00	
Tax payable on balance \$47,100 @ 22%	<u>10,362.00</u>	23,137.00
Less: GST rebate*		<u>500.00</u>
		22,637.00
Less: Tax deducted at source		<u>2,600.00</u>
Tax payable		20,037.00
Less: Tax previously assessed		<u>29,208.00</u>
Amount of tax to be discharged		<u>9,171.00[#]</u>

* assuming that GST rebate of \$500 is available for YA 2000

[#] *Assuming that the taxpayer has paid up the original amount of tax not under deferral, i.e. \$7,095 (\$29,208 - \$22,113), the amount of tax to be refunded to the taxpayer arising from the amendment would be \$7,095 - (\$20,037 - 19,710) = \$6,768.*

Revised computation of tax on ESOP gains to be deferred

Amount of ESOP gains		<u>\$100,000</u>
Tax on ESOP gains applying the revised marginal tax rates:		
Tax payable on	\$47,100 @ 22%	10,362.00
	\$25,000 @ 20%	5,000.00
	\$25,000 @ 16%	4,000.00
	<u>\$ 2,900 @ 12%</u>	<u>348.00</u>
Tax payable on	<u>\$100,000</u>	<u>\$19,710.00</u>

Revised amount of tax on ESOP gains to be deferred

\$19,710.00

Computation of interest charge

Date of original assessment 1 July 2000 (payment due on 31 July 2000)

Date of amended assessment 1 Oct 2000 (payment due on 31 Oct 2000)

Deferral period Up to 31 December 2004

Average prime rate:

15 April 2000

15 April 2001 5.5%

15 April 2002 5%

15 April 2003 6%

15 April 2004 5%

Interest charge would be computed as follows:

<i>1 Aug 2000*</i> – 14 Apr 2001	<i>\$19,710</i> x 5% x 257/365	693.90
15 Apr 2001 – 14 Apr 2002	\$19,710 x 5.5%	1,084.05
15 Apr 2002 – 14 Apr 2003	\$19,710 x 5%	985.50
15 Apr 2003 – 14 Apr 2004	\$19,710 x 6%	1,182.60
15 Apr 2004 – 31 Dec 2004	\$19,710 x 5% x 261/365	<u>704.70</u>
Total interest charge (payable on 31 Dec 2004)		<u>4,650.75</u>

* *Where the tax deferred on ESOP gains is reduced as a result of an amended assessment, the interest charge will be computed based on the reduced amount of tax deferred over the period of deferral commencing from the date of the first deferral.*

Annex 3
Example 5

Computation of the interest charge

Taxpayer has applied to defer the tax on ESOP gains of \$10,000 for YA 2000, assessed on 1 July 2000, for 5 years. In other words, payment of the tax of \$10,000 will become due on 31 December 2004.

Assume the average prime rate on

15 April 2000 is 5%
15 April 2001 is 5.5%
15 April 2002 is 5%
15 April 2003 is 6%
15 April 2004 is 5%

The interest charge on the deferment of the payment of tax of \$10,000 to 31 December 2004 will be computed as follows:

Interest payable:

1 August 2000 to 14 April 2001	$\$10,000 \times 5\% \times 257/365$	352.05
15 April 2001 to 14 April 2002	$\$10,000 \times 5.5\%$	550.00
15 April 2002 to 14 April 2003	$\$10,000 \times 5\%$	500.00
15 April 2003 to 14 April 2004	$\$10,000 \times 6\%$	600.00
15 April 2004 to 31 December 2004	$\$10,000 \times 5\% \times 261/365$	<u>357.53</u>
		<u>2,359.58</u>

Example 6

Assuming that the taxpayer in Example 5 made partial repayments on the following dates:

14 April 2001	\$ 6,000
31 December 2001	\$ 2,000
14 April 2003	<u>\$ 2,000</u>
	<u>\$10,000</u>

The interest charge on the deferment of the payment of tax of \$10,000 will be computed and payable on 14 April 2003 as follows:

Interest payable:

1 August 2000 to 14 April 2001	$\$10,000 \times 5\% \times 257/365$	352.05
15 April 2001 to 31 December 2001	$\$4,000 \times 5.5\% \times 261/365$	157.32
1 January 2002 to 14 April 2002	$\$2,000 \times 5.5\% \times 104/365$	31.34
15 April 2002 to 14 April 2003	$\$2,000 \times 5\%$	<u>100.00</u>
Total interest payable		<u>640.71</u>